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Deskundigheid of financiële controle

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EXPERTISE OR FINANCIAL CONTROL

A simulation study of the policy followed in nominating executives and directors

SUMMARY *)

The roots of this investigation lie in the controversy surrounding the question of whether or not it is socially desirable that some directors of large companies simultaneously occupy so many supervisory directorships in other corporations. The standpoints in this discussion are divergent. Some observers are concerned, and believe that in this way too small a group of individuals possesses too much uncontrolled power and influence. Others maintain that their power and influence is not that extensive. This second group finds in addition that a cumulation of positions is unavoidable in a system in which experts are expected to play an important role.

This problem was researched in the Netherlands using a network analysis approach; the work was done by a group of political scientists at the University of Amsterdam ("Graven naar macht, Op zoek naar de kern van de Nederlandse economie, Helmers, et al, 1975. English translation: Traces of power, Searching for the core of the Dutch economy). The distinctive feature of this study is that it represents multiple directorships as linkages among various different firms. The researchers interpret the results in terms of what is frequently called the "financial control theory". According to this theory, corporations - primarily those operating in the area of finance - use multiple directorships to influence decision-making in other companies in order to promote their own financial and economic interests.

The appearance of this study did not cause the controversy surrounding this theme to subside. Rather it was shifted to an exchange of views over the question of whether or not networks could, in fact, be interpreted in this way, and whether or not the explanation was concluding too much on the basis of too little information. This latter question was posed primarily by individuals who were familiar with this type of nomination on the basis of personal experience. Their objections could be converted into an alternative explanation of the networks, which can best be delimited with the term "theory of expertise". This theory seeks the explanation of the peculiar structure of these networks in the simple fact that there are a limited number of financial experts available. Financial expertise is scarce; the greatest demand for it comes from financial institutions, but other types of business firms also have an interest in it. Financial experts will therefore accumulate relatively more directorships than other types of experts. Their multiple directorships in turn, when depicted in networks, will afford the financial institutions a central position in them. The discussion about the social significance of multiple directorships has thus been brought, in the research-technical sense, into a position of stalemate. A relationship is established in both theories between the way in which individuals are nominated, and the networks which can be expected to develop on the basis of this nomination policy. This relationship cannot, however, be tested empirically, because it involves access to confidential information.

This unsatisfactory situation gave rise to an attempt to look for a different research method, which might be able to introduce a greater

degree of clarity into the discussion. The decision was made to introduce computer simulation as a research method.

Three things were done to make computer simulation for this goal possible:

1. A reconstruction was made for each of the two theories depicting the course of nomination decision-making.

This reconstruction demonstrated that the theories contradict one another less than the original discussion would lead us to suppose. The financial control theory actually only made pronouncements concerning a limited number of nominations: those which were linked directly to external interests. No statements were made regarding all the remaining nominations. The theory had in fact to be regarded as an extension of the theory of expertise. As a result of these considerations, an elaboration of the statement of the problem was arrived at, formulated in the following two questions:

- a. To what extent can the specific network characteristics which led to the formulation of the financial control theory be explained by the theory of expertise?
- b. Is it possible to develop an equally good or a better explanation of this network characteristics by supplementing it with the minimum preliminary conditions of the financial control theory?

2. It was sought out whether or not other information existed which could be used in the design and critical assessment of the model.

A report is given in chapter 2 of a perusal of the relevant literature, aimed at collecting information to be used in designing and critically assessing the model. An inventory was made of a number of legal requirements and rules which applied to the nomination of supervisory directors in large corporations ("Structuurwet" -Law on Structures). We were able to supplement this cataloguing of regulations with empirical observations concerning how they were applied and how they functioned in practice.

3. An attempt was made to ascertain which network characteristics from the empirical investigations could be used to judge whether or not the simulated networks corresponded with the empirical networks.

In chapter 2 a report is also presented of an inventory of the network criteria which have been employed in other investigations. These criteria were examined to determine -where possible- whether they were corroborated in other research material. The result was that the criteria from "Traces of Power", which were the most important ones for our investigation, failed to live up to expectations and had to be abandoned. The network criteria which were finally retained were derived from recent research (Van der Knoop, et al, 1984; Stokman, et al, 1985).

After the theories had been reconstructed in this way, and information had been assembled for designing the model, the simulation model was formulated in chapter 3. It had to be set up in such a way that the parts of the model about which reasonable certainty existed were stipulated, while the parts of the model and/or relationships which were not yet clear could be specified by the user himself. This "half-open" model was submitted to experts, with the request that they specify it and give their opinion on its construction and results. Based partly on their reactions, adjustments and additions were made to the model until an acceptable basic model was obtained which could serve as a point of departure for the specification of the separate

theories. The investigation of both theories was set up using this model.

In chapter 4 the investigation into the theory of expertise is presented. The goal was to examine whether or not it was possible to operationalize the theory of expertise in such a way that the right networks would be generated as a result. The result would be regarded as being successful only when a number of previously formulated criteria were shown to have been satisfied at the same time at the level of the nomination proceedings.

Initially, the theory of expertise appeared to demonstrate a number of strong points with respect to the explanation of the network. The simulated networks displayed characteristics which had previously been attributed to the financial control theory. There were a number of clear-cut differences, however, which made it impossible to accept the theory of expertise as an adequate explanation of the networks.

Because the theory of expertise could not provide the basis for a satisfactory reproduction of the networks, an attempt was made in chapter 5 to discover to what extent models based on the financial control theory could accomplish this task.

Only one of the six model variants which were investigated proved to be capable of generating networks and model results which at all resembled the data with which we are familiar from empirical research. An attempt was made to improve the results of this model by means of alterations in the area of theory-neutral specifications. These alterations did, indeed, lead to improvements, but not in all parts of the model.

A comparison of both theories in chapter 6 revealed the following:

- Although a stricter selection of individuals on the basis of expertise led to better network characteristics, the best variant of the theory of expertise reached no farther than a reasonable representation of events at the model level.
- The financial control theory yielded not only a reasonable representation of the model events, but proved capable in addition of accurately reproducing the dynamics of that network.
- Neither of the two theories yielded models which accurately portrayed the distinctive structure of the networks. This was because the theories were unable to explain the characteristic cumulative pattern of positions held by former executives.

Finally, the conclusion is reached in chapter 7 that the question with respect to the social significance of the multiple directorships cannot be answered by pointing to a scarcity of expertise, nor by putting forward the theory that financial institutions use the multiple directorships to influence decision-making in other firms. Their are, however, indications that an augmentation of these theories with a description of the characteristic process of recruitment among former executives may result in a comprehension of the social significance of multiple directorships.